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UNCLAS SECTION 01 OF 03 VIENNA 000045

SIPDIS

PASS TREASURY FOR OASIA/ICB/VIMAL ATUKORALA
TREASURY ALSO FOR OCC/EILEEN SIEGEL
TREASURY ALSO PASS FEDERAL RESERVE
USDOC PASS TO OITA
USDOC FOR 4212/MAC/EUR/OWE/PDACHER
PARIS FOR USOECD
FRANKFURT FOR TREASURY

E.O. 12958: N/A
TAGS: ECON EFIN ELAB AU EUN
SUBJECT: AUSTRIA'S 2005/06 GROWTH OUTLOOK ?EAN

REFS: (A) 04 VIENNA 3647; (B) 04 VIENNA 0273

SUMMARY

¶1. Austria's GDP grew 2.0% in 2004, driven by booming exports in response to strong world economic growth, according to two leading Austrian economic institutes. The institutes now forecast real GDP growth of 2.2-2.3% in 2005 and 2.2-2.4% in 2006. The strong Euro, high oil prices and the U.S. twin deficits represent downward risks for the 2005/2006 forecasts. However, economists do not see recession as a possibility. The recovery is still export-driven. Investments should recover only in 2006, but private consumptions should pick up soon when the 2005 income and corporate tax cuts take effect. These tax cuts will cause the public sector deficit to rise from 1.3% of GDP in 2004 to at least 1.9% in 2005. The GoA's 2006 deficit goal is 1.7%. Employment growth in both 2005 and 2006 will have little effect on the unemployment rate of 4.2-4.4%. Inflation will tick up to 1.9-2.3% in 2005 and ease to 1.7% in 2006. END SUMMARY.

MODERATE 2004 RECOVERY

¶2. The Austrian Institute for Economic Research (WIFO) and Institute for Advanced Studies (IHS) recently presented their latest 2004 estimates, revised projections for 2005 and a first forecast for 2006. For 2004, WIFO and IHS maintained their estimate from September for GDP growth of 2.0%. They agreed that the Austrian economy had gained momentum in 2004, mainly as a result of booming exports to Germany, the U.S., the ten new EU member states, and some Asian markets. However, the strong Euro and higher oil prices dampened this momentum. While the GoA's extension of the investment premium to the end of 2004 (ref A) stimulated investments, private consumption remained sluggish. Austria's 2.0% growth rate in 2004 was moderate compared to previous cyclical upswings and lagged behind the world economic growth of more than 5.0%. WIFO Deputy Director Ewald Walterskirchen declared that "this is not yet an upswing, which would require at least 3.0% growth."

CONTINUED MODERATE GROWTH IN 2005 AND 2006

¶3. For 2005, the institutes reduced their growth expectations by a quarter of a percentage point, because of the dampening effects of the strong Euro. They now project growth of 2.2-2.3% in 2005. In 2006, all demand aggregates should contribute more evenly to economic growth of 2.3-2.4%. However, this implies a lower Euro exchange rate and lower oil prices. The 2005 forecast reflects an estimated .25% boost to growth from the GoA's 2005 income and corporate tax cut (ref B). Less robust global economic growth, in combination with a strong Euro, will slow Austrian export growth. Investments will grow moderately in 2005, since many companies moved forward investments in 2004 in response to the GoA's investment premium (ref A). However, economists predict investments will pick up again in 2006 because of necessary investments in new technologies and record high business profits. An improved employment outlook and the income tax cut should stimulate consumption in both 2005 and 2006. The savings rate will rise from 8.1% of disposable incomes in 2004 to around 8.5% in 2005/2006, according to the Austrian National Bank (ANB).

¶4. The WIFO and IHS 2005/2006 forecasts are in line with recent ANB projections for real GDP growth of 2.3% in 2005 and 2.1% in 2006; OECD growth projections of 2.3% and 2.6%, respectively; and European Commission predictions of 2.4% growth for both years.

¶5. An October 2004 Industrialists' Association poll revealed less optimism among members, compared to previous polls, regarding the business outlook over the next six months. This seems to confirm analysts' prediction that the peak of the industrial cycle is

already over. A year-end public opinion poll revealed that the Austrians have become more pessimistic about the economic future: 36% view the coming year "with skepticism" (compared to 33% at year-end 2003); 35% "with confidence" (down from 43%); and 29% expect no change.

RISKS ?XCHANGE RATES, OIL PRICES, U.S. TWIN DEFICITS
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¶6. WIFO Director Helmut Kramer listed several exogenous factors that could negatively affect growth: unfavorable exchange rates; higher oil prices; and the twin deficits in the U.S. Kramer predicted Austrian exports would continue to grow, but at a slower pace than in 2004. Nevertheless, Kramer cautioned that continued growth is dependent on stable oil prices and a halt in the dollar's slide vis-`-vis the Euro. IHS director Bernhard Felderer identified exchange rate developments as the greatest risk for the 2005/2006 forecasts. Despite these uncertainties, neither institute foresees a scenario of recession.

¶7. The ANB also considers exchange rates and oil prices as the greatest risks to its 2005/2006 forecasts. The ANB calculated that a 10% increase in the Euro exchange rate in 2005 would reduce Austrian GDP growth by 0.1% in both 2005 and 2006. A 20% increase in oil prices in 2005 would reduce Austrian GDP growth by 0.15% and 0.25% in 2005 and 2006, respectively.

ASSUMPTIONS FOR GROWTH FORECASTS

¶8. The institutes based their 2005/2006 forecasts on the following assumptions:
-- U.S. economic growth of 2.8-3.3% in 2005 and 3.1-3.5% in 2006;
-- Euro area growth of 1.7% in 2005 and 2.2% in 2006;
-- EU-25 growth of 2.0% in 2005 and 2.3% in 2006;
-- German growth of 1.3% in 2005 and 1.6-1.8% in 2006;
-- oil prices of USD 40-42 per barrel in 2005 and USD 38-40 in 2006; and
-- dollar/Euro exchange rates of 0.75-0.76 in 2005 and 0.76-0.78 in 2006.

INFLATION TO TICK UP, UNEMPLOYMENT RATE STICKY
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¶9. In 2004, one quarter of Austria's 2.0% inflation rate was due to higher oil prices. WIFO has revised its 2005 inflation forecast upward to 2.3%, due to higher energy prices, a rise in the tobacco tax and rising housing costs. For 2006, the institutes expect inflationary pressures to ease to 1.7%. However, this decrease in inflation implies a decline in the price of oil to USD 38-40 per barrel in 2006.

¶10. WIFO and IHS predict no significant reduction in the unemployment rate. Rising labor demand will be offset by a continued influx of foreign labor, measures to raise the retirement age, and more women entering the labor market. Thus, despite a marked increase in employment in both 2005 and 2006, the projected 2005 unemployment rate of 4.4% is only marginally lower than the expected rate of 4.5% in 2004. The unemployment rate should again decrease marginally to 4.2-4.3% in 2006.

PUBLIC DEFICIT GROWING

¶11. Due to the investment premium extension, tax revenue shortfalls and a lower profit transfer from the ANB, the institutes estimate the total public sector deficit will be 1.3% of GDP in 2004. In 2005, the income and corporate tax cuts will push the deficit to at least 1.9%. In a November 2004 update of its 2004-2008 Stability Program, the GoA predicted a 1.7% deficit in 2006, a 0.8% deficit in 2007, and a balanced budget in
¶2008. WIFO Director Kramer noted the 1.7% deficit projection for 2006 acknowledges that there will most likely be increased spending in an election year. Kramer doubted that the GoA would balance the budget in 2008, noting this would require further austerity measures.

¶12. Statistical Annex

Austrian Economic Indicators
(percent change from previous year, unless otherwise stated)

	WIFO project. 2005	IHS project. 2005	WIFO project. 2006	IHS project. 2006
Real terms:				
GDP	2.2	2.3	2.3	2.4
Manufacturing	4.0	n/a	3.7	n/a
Private consumption	2.1	2.5	2.2	2.1
Public consumption	0.5	0.2	0.8	0.2
Investment	1.6	2.4	2.7	3.1

Exports of goods	6.0	6.6	7.0	7.1
Imports of goods	6.0	5.9	7.1	6.2
Nominal Euro billion equivalents:				
GDP	244.7	246.0	254.3	256.0
Other indices:				
GDP deflator	2.3	2.0	1.6	1.7
Consumer prices	2.3	1.9	1.7	1.7
Unemployment rate	4.4	4.4	4.2	4.3
Current account (in percent of GDP)	-1.0	-0.1	-1.1	-0.4
Exchange rate for US$ 1.00 in Euro	0.75	0.76	0.78	0.76

BROWN